



City of Rowlett
Special Work Session Minutes
City Council

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Tuesday, May 29, 2012

5:30 P.M.

Municipal Building - 4000 Main Street

As authorized by Section 551.071 of the Texas Government Code, this meeting may be convened into closed Executive Session for the purpose of seeking confidential legal advice from the City Attorney on any agenda item herein.

The City of Rowlett reserves the right to reconvene recess or realign the Regular Session or called Executive Session or order of business at any time prior to adjournment.

Present: Mayor Gottel, Mayor Pro Tem Phillips, Councilmember Davis, Councilmember Pankratz, Councilmember Miller and Councilmember Gallops

Absent: Deputy Mayor Pro Tem Kilgore

1. CALL TO ORDER

Mayor Gottel called the meeting to order at 5:30 p.m.

2. WORK SESSION ITEM

2A. Presentation regarding revenue bonds and covenants and other financial aspects of the Utility Enterprise System.

Staff stated the Utility Fund is an enterprise fund, which is based on the revenue that it receives from ratepayers not taxpayers. Stated the financial aspects of an enterprise fund are different. This meeting is meant to provide information on Revenue Bonds, and the financial implications to ratemaking and bond conveyances. Stated the utility rates will need to be increased this year for two reasons. First, the North Texas Municipal Water District (NTMWD) will be adding needed infrastructure to deal with the Lake Texoma issue. Secondly, the City is underfunded from a maintenance perspective.

Boyd London, Managing Director of First Southwest, began his presentation regarding revenue bonds. State the City basically has two ways to it raises capital money: issue bonds payable

from a property tax and revenue bonds. Stated the pledge of revenues are used to pay revenue bonds.

A member of Council asked why the general fund and the revenue fund should remain separate.

Staff stated that all taxpayers are not ratepayers; stated for revenue bonds, the people who benefit from the service, pay for the service.

A member of Council asked who are ratepayer and not taxpayers.

Staff stated everyone in the City pays taxes but there are people that are not within the City limits. Further stated there are citizens that receive water service but not sewer service and vice versa. Stated approximately 10% of citizens only pay for water as they have a septic system.

Mr. London continued with his presentation.

Spoke regard the legal authority for revenue bonds.

- Stated the 1876 Texas Constitution gives the State Legislature authority to legislate local government's ability to issue bonds
- Laws are very specific about how an issuer can proceed
- Attorney General approves each bond issue for legality
- Comptroller registers each bond issue

Spoke regarding how water and sewer revenue bonds work and the priority of net revenues available for debt service.

Staff stated the City has an obligation in the its rate conveyance to have maintenance to maintain the system and to maintain the investment.

Mr. London continued with his presentation.

Can A Property Tax Be Levied To Pay Water And Sewer Revenue Bonds?

- The bonds are payable solely from revenues of the water and sewer system.
- A city may levy a property tax to pay operation and maintenance expenses.

Key Bond Covenants

- Bond Sinking Fund
 - Annual Principal & Interest Payments, funded monthly
- Bond Reserve Fund
 - For the protection of the bond holder
 - To be used only when revenues are insufficient to pay debt service
 - Not available for any other purpose

- Rate Maintenance
 - 1.20x Annual Debt Service
 - Bond rating agencies prefer 1.6x to 1.8x

A member of Council asked how interest rates are determined.

Mr. London stated the market determines the rate.

Staff stated next fiscal year there will be freed up bond capacity and the City could reissue without changing the utility rates. Staff punctuated if the NTMWD had moved to Stage 4 water restrictions, the City would have seen a large revenue reduction that would have required a surcharge to ratepayer to meet the 120% obligation.

Mr. London stated General Obligation (GO) bonds can be issued for any public purpose, water and sewer included. Stated usually GO bonds are issued when the interest rate is better for the GO bond pledge than with the water and sewer bond pledge.

What are Key Covenant Bonds?

- Interest and Sinking Fund – A segregated and restricted fund created for the payment of principal and interest on the bonds. Rate of fill is specified in the bond ordinance.
- Bond Reserve Fund – Another segregated and restricted fund equal to an average annual principal and interest requirement. It is available only to pay debt service if the City has a shortfall in Net Revenues.
 - At a minimum its use triggers a technical default.
- City covenants to levy rates and charges sufficient to pay O&M, debt service, and to produce net revenues of 120% of debt service.
 - Failure to meet this covenant results in a technical default.
- A covenant specifying the conditions the City must meet in order to issue additional bonds.

A member of Council asked if there was any interplay between Municipal Utility Districts (MUD) and municipalities.

Mr. London stated MUD Districts are different than cities; they are independent legislative created bodies. Stated a MUD district is created to help an area to develop. Stated the MUD District pays for the capital improvements.

A member of Council asked if MUD Districts up for consideration for new residential developments.

Staff stated the MUD District has been replaced by the Municipal Management District. Stated they function similarly to a MUD but are better.

Mr. London stated legislation has given local government more power which allows many options to look at in the future.

Mr. London continued with his presentation.

Why Are Bond Covenants Critical?

- They are legally binding on the City. It must comply regardless of the situation.
- They protect an investor from dilution and ensure adequate cash flow to operate efficiently and pay debt service.
- They give the City clear authority to issue additional bonds.
- They provide the discipline to operate the Water and Sewer System in an efficient manner.
 - Generates excess revenue for additional capital improvement (debt avoidance).
- Important - There is no lien on the City's water and sewer system.
 - Bond holders do not want to own or operate any system.

A member of Council asked if there are situations which would limit a City's ability to issue additional bonds.

Mr. London stated you would be limited if you do not generate enough revenue.

Staff stated the City is operating at a level of debt that Moody or Standard & Poors are not comfortable with.

Mr. London stated the City has a responsibility to furnish the citizens with the services they desire. Stated additional debt may prevent a better rating.

What Happens When a Default Occurs?

- A Default is the failure to pay principal and interest on bonds on time.
 - Two types of default.
 - Intentional
 - Accidental and/or Technical
- What are the consequences of an intentional default?
 - Intentional default results in immediate rating downgrade to junk bond status.
- Intentional default bars the issuer from the bond market for an indeterminable amount of time.
 - Eventually high-risk purchasers will provide market access at higher interest rates.
- Credit rating recovery requires remedial action and close coordination with the rating services.
 - Bond market must be educated.
 - Credit ratings are slow to recover. Higher interest rates result.

What is a Bond Rating?

- A bond rating is an opinion from an independent third party of the City's ability to repay its obligations.

- Cannot see the future but does predict the future based upon past and present operations.
- The City presents its information and receives its feedback from the credit report that the credit rating agencies distribute to the bond market.
- No one is dictating anything. Issuers are free to run their government/systems as they deem appropriate.
 - The bond rating agencies communicate solely with the bond market AND represent the bond market.
- The credit rating agencies simply report what they see and can project.
- The City presents its information and receives its feedback from the credit report that the credit rating agencies distribute to the bond market.
- Opinion relies on many factors. The major ones are:
 - How has the City operated the System in the past and present?
 - Are there management policies dictating financial performance, maintenance, capital expenditures, transfers, etc.?
 - Is the City in compliance with its outstanding bond covenants?
 - Is the City timely in addressing its capital/long term maintenance needs?
 - Is the system in compliance with State and federal regulations?
- The bond market relies heavily on these reports when performing their due diligence.
 - Some purchasers may rely exclusively on these reports.

So What?

- Much like an individual, good credit is key.
 - Default on principal and interest payments is never an option.
 - It precludes the City from accessing the market for an extended period at anything approaching market yields.
 - Technical default, such as a late payment, a draw on the Reserve Fund, a failure to fund the Reserve Fund as specified, a failure to set sufficient rates to meet bond covenants, a failure to maintain fund balance, and others put the City's long term bond rating in immediate danger of downgrade.
- In most cases of an intentional payment default bondholders will sue.
 - City temporarily loses some or all control of its system.
 - In Texas, default case law during and after the Depression is clear. If the City covenanted to do it, it will be enforced by a court of law.
- Good bond ratings let the City efficiently enter an established capital marketplace providing excellent interest rates for quality credits.

What Are Other Bond Market Expectations?

- Most ordinances require that Net Available For Debt Service be at specified levels annually.
 - The City has pledged to maintain rates sufficient to generate 1.20 times the Debt Service due on bonds in each year.
 - In reality, the expectation of the credit rating agencies and bond market is higher, around 1.60 to 1.80 times for a city such as Rowlett.

- The brother-in-law/city official rule.
 - No free service allowed. This includes the City's own use.
- No competition is allowed.

Staff stated revenue rates can be adjusted anytime unlike the tax rate. Stated utility revenues are impacted by weather fluctuation. Staff further stated that there are competing needs with the obligation to bond holders and the aging system.

How is Water Supplied to the City?

- City contracts with NTMWD to provide it with sufficient water to meet its needs.
 - City is one of several other cities with NTMWD contractual arrangements.
- NTMWD pledges these contracts collectively to revenue bonds that it issues for the construction of infrastructure needed to ensure delivery of its water supply obligation to all parties.

My Credit Rating And Bond Market Observations

- A key "black box" component of a rating is fiscal management.
- This begins and ends with Council decisions and actions.
- How an issuer responds to challenges that it may face is the true measure of the fiscal management component.

A member of Council asked how the City's bond rating increased with the lack of maintenance.

Mr. London stated the rating agencies do not know about the lack of maintenance; however, the rating agencies do monitor how much debt is being issued.

Staff presented a PowerPoint presentation and gave a brief history of this item.

Spoke regarding Reinvestment in Capital Maintenance.

- Utility Assets
 - City' system is valued at \$342 million
 - Assume it has a life expectancy of 30 years, approx. \$11.4 million should be spent annually for maintenance
- How much do we allocate now?
 - City current allocates \$550k or 0.16%
 - City also contributes \$1.0 million to Cash CIP for streets & alleys
 - 2004-2006 Revenue Bonds are nearly spent
- 2003 Study
 - Study from Freese & Nichols suggested the City allocate \$2.4 Million annually
 - DFW CPI increases that amount to \$2.8 million by FY2012

What's in a Utility Rate?

- O&M
 - Line Maint. / Fire Hydrants

- Pump Stations / Water Tanks
- Sewer Lift Stations / Manholes
- Contract Costs
 - NTMWD (water)
 - Garland (sewer)
 - Wholesale
- Debt
 - Principal & Interest on Bonds
 - 5-yr CIP (long-term financing)
- Transfers
 - Cash CIP
 - G&A / Franchise Fees
 - Economic Development

Spoke regarding the breakdown of the utility rate. Stated O&M declined 11% as a percent of the total utility rate between 2004 and 2012 to make room for increased debt and the cost of buying water from NTMWD and treating sewer from Garland. Spoke regarding water acquisition and sewer treatment. Stated NTMWD has increased their water rates by 9% annually since 2007; and Garland has increased their sewer treatment rates by 8% annually since 2007. Spoke regarding debt. Stated annual debt service payments jumped from \$2.6M to \$5.6M from 2004 to 2007; and added \$37.5M in new debt between 2004-2006, more than doubling the existing debt.

Staff stated best management practice is to issue bonds according to the capacity to use it.

Spoke regarding transfers. Stated the City transferred \$5.2M to Cash CIP for streets and alleys between FY2008-FY2011; and the City transferred \$1.8M to Cash CIP for utility related purposes between FY2008-FY2011.

Why Does Rowlett's Rates Exceed the Area Averages?

- Some cities do not charge entire cost of service and subsidize rates from General Fund.
- Some cities use tax bonds to fund water/sewer system construction.
- NTMWD/Garland – both have implemented aggressive capital improvement plans due to increasing growth and to improve quality of service increasing the annual cost by \$3.6M since 2004.
- Rowlett doubled its debt between 2004-2006 by \$37.5M. This added about \$13 per month per customer.

Staff stated the Metroplex has grown tremendously and NTMWD will have to grow to keep up with the population growth. Stated NTMWD is expected to raise water rates 50% over three years.

Why Doesn't Rowlett buy its Water from some other Source?

- Contract Obligation

- City locked into contract with NTMWD until 2024.
- Would still need to annually pay \$5.0M+, even if we don't use a drop.
- Infrastructure
 - Rowlett does not have the infrastructure to get water from anyone else.
 - To build the transmissions lines, storage facilities and other infrastructure could cost \$100M to \$200M.
- Take or Pay
 - NTMWD uses a city's maximum usage in any one year to set the minimum allotment.
 - Dallas, however, uses a city's maximum usage on a daily basis to set the minimum allotment.

Spoke regarding wholesale water rates. Stated the City of Dallas increased their wholesale rates from \$1.36 to \$1.61 or 18% between 2005 and 2011; and the NTMWD increased their wholesale rates from \$1.02 to \$1.42 or 39% between 2005 and 2011.

Spoke regarding how the City got here.

- New growth
 - Added 6,133 or 75% homes between 1990-2000.
 - What were the City's standards then?
- Drought
 - City has experienced two droughts in 2006 and 2011.
 - Exacerbated ground conditions and accelerated system decline.

Staff stated as a result of the soil conditions, the audit depreciates the infrastructure over a 30 year useful life schedule. Stated the City is beginning to see the implications of the 2006 drought and will start seeing the implications of the 2011 drought in a few years.

- Cash CIP
 - Transferred \$5.2M to streets & alleys between 2008-2011.
 - During the same period, City transferred only \$1.8M for water & sewer.

Key System Challenges

- Price Sensitivity
- Antiquated Technology
- Obsolete Equipment
- Water Pressure
- Maintenance
- Capital Reinvestment
- (CIP)

Spoke regarding what the cost will look like for Rowlett customers.

A member of Council stated commercial growth will not fundamentally change the tax base.

Staff stated the Realize Rowlett 2020 consultants have been asked to project the tax value at build out and to project how quickly they think this will happen.

A member of Council stated we do not know what the economy will be like next year. Will the citizens be going through tough financial times?

Staff stated choices will have to be made because we have run out of choices.

A member of Council stated saying 'no' to some developments may make a greater impact for the future.

Staff stated the community is owed transparency and open government. Stated the citizens will have an opportunity to engage and participate in the decisions that are made.

Staff continued with the presentation.

Spoke concerning the cost for capital maintenance. Stated the City has freed up bond capacity in both FY2013 and FY2015 that will not increase rates, but can be used to address capital infrastructure needs as identified in the CIP, such as the upper pressure zone.

Staff stated if the tax base cannot grow, then we must be able to prioritize differently. Stated the point of this meeting was to give background information to provide perspective for the upcoming June conversation.

3. ADJOURNMENT

Mayor Gottel adjourned the meeting at 8:30 p.m.



Todd W. Gottel, Mayor



Stacey Chadwick, Interim City Secretary

Date Approved: June 19, 2012

